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In the Supreme Court of the United States

In the Matter of SASSARD & KIMBALL, INC., Bankrupt, and WM. H. MOORE, Jr., Trustee in Bankruptcy for the Estate of Sassard & Kimball, Inc., Bankrupt,

Appellant and Petitioner.

vs.

O. S. BAY,

Appellee and Respondent.

Appellant's Brief Filed Under Writ of Certiorari Hereinbefore Issued to the United States Circuit Court of Appeals for the Ninth Circuit

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Statement

Sassard & Kimball, Inc., the bankrupt in the proceeding at bar, was at all times before November 23, 1928, and up to and including December 31, 1929, the date of filing of the voluntary petition herein, a merchant engaged in selling automobiles, automobile parts and accessories at Huntington Park, California. The voluntary petition in this proceeding was filed in the United States District

Court for the Southern District of California, on December 31, 1929. On the same day that the petition was filed, Wm. H. Moore, Jr., of Los Angeles, California, was appointed Receiver in Bankruptcy and took possession of the assets of the bankrupt, including the property in litigation here. At the first meeting of creditors thereafter held, Mr. Moore was elected Trustee in Bankruptcy for the estate of the bankrupt.

The property involved in this litigation consists of all the furniture, show room equipment and shop equipment in the place of business of the bankrupt at Huntington Park, California, and two automobiles.

On November 23, 1928, the bankrupt executed and delivered to Sylvan G. Bay a promissory note, bearing even date, for the sum of $10,000.00, payable to the said Sylvan G. Bay, and due thirty days after date. On the same date, November 23, 1928, the bankrupt executed a chattel mortgage, covering all of the furniture, show room equipment and shop equipment in its place of business and two automobiles in favor of Sylvan G. Bay for the purpose of securing payment of the promissory note of $10,000.00, described in the preceding paragraph. The chattel mortgage was acknowledged seven days later on November 30, 1928, and thereafter on December 5, 1928, the affidavit of good faith required by Section 2957 of the Civil Code of California was signed by the mortgagor. This chattel mortgage was then withheld from record for fourteen more days after the execution of the affidavit of good faith required by the California statute, being recorded in the office of the County Recorder of Los Angeles County, California, where the mortgaged property was situated, on December 19, 1928.

Shortly after the recordation of the chattel mortgage, Sylvan G. Bay, the original mortgagee, executed an assignment of it, together with the promissory note secured by it, to the appellee herein, Dr. O. S. Bay, without recourse.

At the time that the chattel mortgage was executed by the bankrupt, it was indebted to a number of existing creditors. These creditors remained creditors of the bankrupt continuously up to and including December 31, 1929, the time of the filing of the petition in bankruptcy, and are creditors of the bankrupt in the bankruptcy proceedings of Sassard & Kimball, Inc.

Between the date of the execution of the chattel mortgage on November 23, 1928, and the date of its recordation on December 19, 1928, another group of creditors sold merchandise to the bankrupt and remained creditors continuously up to and including the time of the filing of the petition in bankruptcy and are now creditors of the bankrupt in the bankruptcy proceedings.

Subsequent to the recordation of the chattel mortgage a third group of creditors came into existence and sold merchandise to the bankrupt on credit and are now creditors of the bankrupt.

When the chattel mortgage in question was executed on November 23, 1928, no notice of intention to mortgage the fixtures and equipment belonging to the bankrupt, Sassard & Kimball, Inc., bankrupt, was recorded in the office of the County Recorder of Los Angeles County, California, where the property was situated. This notice of intention to mortgage is mandatory under the provisions of Section 3440 of the Civil Code of the State of California, and any mortgages covering fixtures

of a merchant or garage owner, given without the recordation of notice of intention to mortgage, are declared by Section 3440 to be conclusively presumed to be fraudulent and void as against existing creditors of the mortgagor.

The Trustee filed a petition before the Referee in Bankruptcy, Rupert B. Turnbull, Esquire, seeking to set aside and avoid this chattel mortgage on the ground that no notice of intention to mortgage had been recorded, and that the mortgage had been withheld from recordation an unreasonable length of time to the detriment of creditors of the bankrupt and in violation of Section 3440, Civil Code of California. The order to show cause issued by the Referee was directed to Sylvan G. Bay, the original mortgagee, as the Trustee had no notice of the assignment of the mortgage. When the matter was reached for trial before the Referee and the true facts became known with regard to the assignment of the mortgage, Dr. O. S. Bay, the real party in interest, was substituted. The facts hereinbefore set forth were stipulated to, and the Referee promptly decreed the chattel mortgage in question to be wholly null and void as against the Trustee in Bankruptcy, and ordered its cancellation.

This order cancelling the mortgage was filed on February 6, 1930. The mortgagee took a review of the Referee's order and on April 24, 1930, Honorable John M. Killets, a District Judge from Ohio, sitting in the Southern District of California under a pro tem assignment, entered an order, together with a memorandum opinion, reversing the order of the Referee and decreeing the chattel mortgage to be valid as to the third class of creditors, whose claims came into existence after its

recordation, but void as to those creditors whose claims were in existence at the time of the execution of the mortgage and whose claims came into existence between the date of its execution and recordation. The result of the reversal was to require the Trustee to pay creditors whose claims were in existence prior to the execution of the mortgage (hereinafter referred to as creditors of the first class) and creditors whose claims came into existence between the date of its execution and recordation (hereinafter referred to as creditors of the scond class) 100 cents on the dollar of the amount of their claims, then to pay Dr. O. S. Bay the $10,000.00 called for under his mortgage, and if anything were left after this admittedly void mortgage was paid, to distribute the leavings to the unfortunate creditors of the third class whose claims came into existence after the recordation of the mortgage.

The Trustee took an appeal to the United States Circuit Court of Appeals for the Ninth Circuit, under Section 24-B of the Bankruptcy Act of 1898, which appeal was allowed, and was argued in October, 1930. On December 6, 1930, the Circuit Court of Appeals handed down a decision affirming the decision of the Judge of the District Court. A petition for rehearing was denied and the Trustee thereupon applied to this Court for a writ of certiorari, which was granted.

ARGUMENT

Points and Authorities

It is the contention of the Trustee and appellant here that both the District Court and the United States Circuit Court of Appeals erred in decreeing that a chattel mort-

gage which was void as to two classes of creditors out of three could not be avoided *in toto*, by the Trustee, for the benefit of all of the creditors of the bankrupt, and that the Court erred further in making two classes of general creditors preferred creditors in the distribution of the bankrupt's assets, to the detriment of a third class of general creditors. We believe that the doctrine laid down by the two lower Courts is in direct violation of Section 65-A of the Bankruptcy Act and is contrary to the opinion of this Court construing Section 65-A in *Globe Bank v. Martin*, 236 U. S. 288, and further that it is in direct conflict with decisions of four Circuit Courts of Appeal in eastern Circuits which have passed upon this same question.

Statutory Provisions

Section 3440 (Division 4, Part 2, Title 2), *Civil Code of the State of California*, as it existed at the time of the mortgage complained of, reads as follows, in so far as material here:

> "Every transfer of personal property, other than a thing in action, or a ship or cargo at sea or in a foreign port, and every lien thereon, other than a mortgage, when allowed by law, and a contract of bottomry or respondentia, is conclusively presumed if made by a person having at the time the possession or control of the property, and not accompanied by an immediate delivery, and followed by an actual and continued change of possession of the things transferred, to be fraudulent, and therefore void, against those who are his creditors while he remains in possession, and the successors in interest of such creditors, and against any persons on whom his

estate devolves in trust for the benefit of others than himself, and against purchasers or encumbrancers in good faith subsequent to the transfer * * *. Provided, also, * * * that the sale, transfer, assignment or mortgage of the fixtures or store equipment of a * * * garage owner * * * or retail or wholesale merchant, will be conclusively presumed to be fraudulent and void as against the existing creditors of the vendor, transferor, assignor or mortgagor, unless at least seven days before the consummation of such sale, transfer, assignment or mortgage, the vendor, transferor, assignor or mortgagor or the intended vendee, transferee, assignee, or mortgagee, shall record in the office of the county recorder in the county or counties in which said * * * fixtures or equipment are situated a notice of said intended sale, transfer, assignment or mortgage, stating the name and address of the intended vendor, transferor, assignor or mortgagor, and the name and address of the intended vendee, transferee, assignee or mortgagee, and a general statement of the character of the merchandise or property intended to be sold, assigned, transferred or mortgaged, and the date when and the place where the purchase price or consideration, if any there be, is to be paid."

Section 2957 of the *Civil Code of the State of California* (Division 3, Part 4, Title 14, Chapter 2, Article 3) reads as follows:

"A mortgage of personal property is void as against creditors of the mortgagor and subsequent purchasers and encumbrancers of the property in good faith and for value, unless:

"1. It is accompanied by the affidavit of all the parties thereto that it is made in good faith and

without any design to hinder, delay, or defraud creditors;

"2. It is acknowledged or proved, certified, and recorded in like manner as grants of real property."

Section I, subdivision 25, of the *Bankruptcy Act of 1898* reads as follows:

> " 'Transfer' shall include the sale and every other and different mode of disposing of or parting with property, or the possession of property, absolutely or conditionally, as a payment, pledge, mortgage, gift, or security."

Section 70-A of the *Bankruptcy Act of 1898,* in so far as material here, reads as follows:

> "The Trustee of the estate of a bankrupt, upon his appointment and qualification, and his successor or successors, if he shall have one or more, upon his or their appointment and qualification shall in turn be vested by operation of law with the title of the bankrupt, as of the date he was adjudged a bankrupt, except in so far as it is to property which is exempt, to all * * * (4) property transferred by him in fraud of his creditors; (5) property which prior to the filing of the petition he could by any means have transferred or which might have been levied upon and sold under judicial process against him."

Section 70-E of the ***Bankruptcy Act of the United States of 1898*** **reads as follows:**

> "The Trustee may avoid any transfer by the bankrupt of his property which any creditor of such bankrupt might have avoided, and may recover the

property so transferred, or its value, from the person to whom it was transferred, unless he was a bona fide holder for value prior to the date of the adjudication. Such property may be recovered or its value collected from whoever may have received it, except a bona fide holder for value. For the purpose of such recovery any court of bankruptcy as hereinbefore defined, and any State court which would have had jurisdiction if bankruptcy had not intervened shall have concurrent jurisdiction."

Section 67-A of the *Bankruptcy Act of 1898* reads as follows:

"Claims which for want of record or for other reasons would not have been valid liens as against the claims of the creditors of the bankrupt shall not be liens against his estate."

Section 67-B of the *Bankruptcy Act of 1898* reads as follows:

"Whenever a creditor is prevented from enforcing his rights as against a lien created, or attempted to be created, by his debtor, who afterwards becomes a bankrupt, the trustee of the estate of such bankrupt shall be subrogated to and may enforce such rights of such creditor *for the benefit of the estate.*" (Italics ours.)

Section 65-A of the *Bankruptcy Act of the United States* reads as follows:

"Dividends of an equal per centum shall be declared and paid on all allowed claims, except such as have priority or are secured."

Section 64-B of the *Bankruptcy Act of 1898* reads as follows:

"The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment shall be (1) the actual and necessary cost of preserving the estate subsequent to filing the petition; (2) the filing fees paid by creditors in involuntary cases, and, where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the expense of one or more creditors, the reasonable expense of such recovery; (3) the cost of administration, including the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fees, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases while performing the duties herein prescribed, and to the bankrupt in voluntary and involuntary cases, as the court may allow; (4) where the confirmation of composition terms has been refused or set aside upon the objection and through the efforts and at the expense of one or more creditors, in the discretion of the court, the reasonable expenses of such creditors in opposing such composition; (5) wages due to workmen, clerks, traveling or city salesmen, or servants, which have been earned within three months before the date of the commencement of the proceeding, not to exceed $600 to each claimant; (6) taxes payable under paragraph (a) hereof and (7) debts owing to any person who by the laws of the states or the United States is entitled to priority: Pro-

> vided that the term 'person' as used in this section shall include corporations, the United States and the several states and territories of the United States."

Section 47-A-2 of the *Bankruptcy Act*, in so far as material here, reads as follows:

> "And such trustees, as to all property in the custody or coming into the custody of the bankruptcy court, shall be deemed vested with all the rights, remedies, and powers of a creditor holding a lien by legal or equitable proceedings thereon; and also, as to all property not in the custody of the bankruptcy court, shall be deemed vested with all the rights, remedies, and powers of a judgment creditor holding an execution duly returned unsatisfied."

It is our contention that under Section 3440 of the Civil Code of the State of California this mortgage was wholly void as to the Trustee in Bankruptcy, even without the assistance of Sections 70-A and 47-A of the Bankruptcy Act of the United States. The Court will note that Section 3440 makes a transfer of personal property, without immediate delivery and actual and continued change of possession of the property involved, fraudulent and void as against those who are his creditors while he remains in possession *and the successors in interest of such creditors and against any person on whom his estate devolves in trust for the benefit of others than himself.* (Italics ours.)

The Trustee in Bankruptcy, being a "person on whom the estate of the debtor devolves in trust for the benefit of others," is thus placed in the class of persons who could avoid a transfer or mortgage of personal property given without prompt recordation or immediate

change of possession under the provisions of this code section.

Francisco v. Aguirre, 94 Cal. 180.

Prior to the adoption of the recording statutes of the State of California, it was necessary to the validity of a chattel mortgage that the property mortgaged be immediately delivered to the mortgagee under Section 3440 of the Civil Code. Possession of the mortgaged chattels was retained by the mortgagee until the mortgage had been satisfied or paid, otherwise the mortgage was void as to creditors of the mortgagor while he remained in possession.

Chenery v. Palmer, 6 Cal. 119;
Ruggles v. Cannedy, 127 Cal. 290;
Hopper v. Keyes, 152 Cal. 488.

Thereafter the Legislature of California passed the recording statutes, providing for the recordation of chattel mortgages in the county in which the mortgaged property is situated and the courts of California have held that the recordation required by Section 2957 of the *Civil Code of California* must be made as promptly as the required delivery under Section 3440, prior to the enactment of the recording statutes.

"The law may be said to contemplate or require immediate recordation because the rights of creditors arising before recordation are superior to those of the mortgagee, or it may be said that, while the law does not exact immediate recordation, it renders the mortgage void as to such creditors until it be so recorded."

Ruggles v. Cannedy, 122 Cal. 290.

At another place in the same decision (*Ruggles v. Cannedy,* supra) the Court says:

> "We conclude upon this question that our law requires immediate recordation in lieu of immediate delivery, and that when such recordation is not effected, the mortgage is void *as against creditors of the mortgagor*. The penalty for a failure to record promptly in a case of a mortgage is identical with the penalty under Section 3440 for a failure to deliver promptly in the case of a sale. In either case, the failure results in a legal fraud against those whom the statute enumerates and protects." (Italics ours.)

We therefore conclude from the foregoing decisions of the Supreme Court of California that any person on whom the estate of the debtor devolved in trust for the benefit of others could have avoided this mortgage under Section 3440, if for no other reason than the fact that recordation thereof was not had immediately.

As far back as 1883, the Supreme Court of California has held that an assignee in insolvency of a vendor was a successor in interest of the vendor's creditors and was also one on whom his estate devolved in trust for the benefit of others than himself and as such had a right to avoid a mortgage or transfer of personal property made without immediate delivery and actual and continued change of possession.

In *Merrill v. Hurlburt,* 63 Cal. 494, the Supreme Court of California, after quoting Section 3440 of the Civil Code of California, says:

> "The assignee in insolvency of the vendor was a successor in interest of his creditors and was one

'on whom his estate devolved in trust for the benefit of others than himself.'"

This doctrine has been followed by the Supreme Court of California in the following subsequent decisions:

Brown v. Bank of Napa, 77 Cal. 546;
Francisco v. Aguirre, 94 Cal. 180;
Ruggles v. Cannedy, 127 Cal. 290-304.

In *Brown v. Bank of Napa,* 77 Cal. 544-46, the Supreme Court of California says:

"We think that the assignee in insolvency is a person on whom the estate of an insolvent devolves in trust for the benefit of others. Such estate devolves upon the assignee by operation of law under the statutes in relation to insolvents in this state (see article 4 of the Insolvent Act, section 17) for the benefit of others, viz., the creditors of the insolvent. Of the correctness of this position, we do not entertain a doubt.

"It was so held in Merrill v. Hurlburt, 63 Cal. 496, by Department One of this court, and we concur in and approve the ruling. It was also held in the case just cited that the assignee was the successor in interest of the creditors. There certainly is much reason for so holding. The creditors cannot sue to recover their debts. The assignee has the right to sue for and recover everything due to the estate for the benefit of the creditors.

"We adhere to this ruling, also, in the case cited."

In *Francisco v. Aguirre,* 94 Cal. 180, the Supreme Court of California, at page 185, says:

"An estate is said to 'devolve' upon another when by operation of law, and without any voluntary act of the previous owner, it passes from one person to

another; but it does not devolve *from* one person to another as the result of some positive act or agreement between them. The word is itself of intransitive significance, and does not include the result of an act which is intended to produce a particular effect. It implies a result without the intervention of any voluntary actor. Instances of its appropriate use are found when speaking of the succession of estates upon death, or upon a change of official incumbents; also in proceedings in bankruptcy or insolvency, where, by the act or operation of law, the estate of the bankrupt devolves upon his assignee."

Trustee's Rights Under Sections 47-A and 70-E

We now come to a consideration of the rights of a Trusteee in Bankruptcy under the Bankruptcy Act itself. In the first place Section 70-A of the Bankruptcy Act confers upon the Trustee in Bankruptcy, as of the date of adjudication, the title of the bankrupt to all property transferred by him in fraud of his creditors, and property, which, prior to the filing of the petition, he could by any means have transferred, or which might have been levied upon and sold under judicial process against him.

Bankruptcy Act, Section 70-A, Sudivisions 4 and 5;
In re Kohler, 159 Fed. 871.

Under Subdivision E of Section 70, the Trustee is given the right to avoid any transfer by the bankrupt of his property which any creditor of the bankrupt might have avoided and to recover the property so transferred, or its value, from the person who received it.

Globe Bank v. Martin, 236 U. S. 288;
Security Warehousing Co. v. Hand, 206 U. S. 415.

Now what right has a Trustee in Bankruptcy to the property in question here? A "transfer" of property as defined in Section I, Subdivision 25, includes a mortgage of property. Therefore the Trustee, under Section 70-E, had a right to avoid the mortgage on this property, if any creditor of the bankrupt could have avoided it. This right is not peculiar to the Bankruptcy Act alone, nor is it a right peculiar alone to Trustees in Bankruptcy. As we have seen from the cases cited in the preceding paragraphs, an assignee in insolvency under California law would have had the same rights to avoid a mortgage or transfer that a Trustee in Bankruptcy has, and both of them are possessed of the rights conferred by Section 3440 of the Civil Code of California on the most favored creditor of the insolvent. What are the rights of the most favored creditor?

In *Butler v. San Francisco Gas & Electric Company*, 168 Cal. 32, the Court says, at page 39:

> "A void thing is as no thing. So far as existing creditors are concerned, the title and ownership of the property remained in the fraudulent grantor as fully as though no transfer had been attempted. In 1 Freeman on Executions, section 136, it is said; 'As against the fraudulent transferee the creditor may seize the property, whether real or personal, as that of the fraudulent vendor, and may proceed to sell it under execution. The title transferred by such sale (on execution) is not a mere equity—not the right to control the legal title and to have the fraudulent transfer vacated by some appropriate proceeding; *it is the legal title itself, against which the fraudulent transfer is no transfer at all.*' This language was quoted and approved by this court in Judson v. Lyford, 84 Cal. 507." (Italics ours.)

In *Bull v. Ford,* 66 Cal. 176, the Supreme Court said:

> "The conveyance to defendant being void, as against Alvarado's creditors, the creditors were authorized to levy upon and sell the property as if no conveyance had ever been made by their debtor. (Freeman on Executions, Section 136, and authorities there cited.) This, the creditor, under whom the plaintiff claims, did; and by virtue of that sale, the interest of Alvarado in the property became vested in the plaintiff."

In *Rohrbough v. Johnson,* 107 Cal. 144-149, the Supreme Court of California says:

> "It has been repeatedly held that a sale of personal property not accompanied by an immediate delivery and an actual and continued change of possession is fraudulent and void as to any creditor who was such during any of the time the property remained in the seller's possession, and that such property may be seized by such creditor in the hands of the buyer in the same manner as though there had been no attempted transfer by the debtor. Waterson v. Rodgers, 53 Cal. 401; Edwards v. Sonoma Valley Bank, 59 Cal. 148. This construction of said section is equally applicable to chattel mortgages other than those authorized by statute and the same rule must apply in determining what is an immediate delivery and actual and continued change of possession, viz: that these questions must be determined upon the facts of each particular case."

The purchaser at execution sale had on behalf of the creditor against whom the transfer is void, may assert his title in an appropriate action and may bring an

action to quiet title and set aside the fraudulent conveyance and thus remove the cloud cast on his title thereby.

12 *California Jurisprudence,* 1031, Section 72 citing:
Wangenheim v. Garner, 42 Cal. App. 332;
Scholle v. Finnell, 166 Cal. 546;
Chalmers v. Sheehy, 132 Cal. 459, and other cases.

We therefore conclude that the Trustee, with the title of the bankrupt to the property already conferred upon him by Section 70-A of the Bankruptcy Act. had a right under Section 70-E and Section 3440 of the Civil Code, to quiet title to and remove the cloud thereon by avoiding the transfer or mortgage made to the appellee Bay.

It was clearly the intention of Congress, in enacting the Bankruptcy Act, to place the Trustee in the most favored position, to the end that he might collect all of the bankrupt's assets, convert them into cash, and disburse the proceeds derived therefrom equally among all of the unsecured creditors of the bankrupt. This is evidenced by the fact that in 1910, as a result of a decision handed down by this Court in *York Manufacturing Company v. Cassell,* 201 U. S. 344, which held that the Trustee stood in the shoes of the bankrupt, and was vested with no better right or title to the bankrupt's property than belonged to the bankrupt at the time when the Trustee's title accrued, it became evident that a serious weakness existed in the Bankruptcy Act. The amendment to Section 47-A of the Bankruptcy Act was therefore enacted vesting the Trustee, as to all property in the custody or coming into the custody of the Bankruptcy Court, with all the rights, remedies and powers of a creditor holding a lien by legal or equitable proceedings there-

on, and as to all property not in the custody of the Bankruptcy Court, with all the rights, remedies and powers of a judgment creditor holding an execution duly returned unsatisfied. This amendment gave rise to the doctrine that the Trustee in Bankruptcy stands in the shoes of the most favored creditor of the bankrupt under the local law. In other words, it converted the Trustee into an "ideal" creditor, one might say, into all kinds of a creditor, for the benefit of all.

Farmers Co-operative Company v. Barlow, 202 Fed. 1008 D. C. N. D.;
In re Johnson, 212 Fed. 311 (D. C. Oklahoma);
Fuller v. Atlanta Bank, 254 Fed. 278 (C. C. A.);
Matter of Seward Dredging Co., 224 Fed. 225 (C. C. A.);
Interstate Bank & Trust Co. v. Brown, 235 Fed. 32 (C. C. A.);
In re Nelson, 191 Fed. 233 (D. C. S. D.)
In re Geiver, 193 Fed. 128 (D. C. S. D.);
In re Hartdagen, 189 Fed. 564 (D. C. Pa.)

Prior to the decision herein complained of, the overwhelming weight of authority throughout the United States has been that a Trustee in Bankruptcy, after taking title to property fraudulently transferred, as provided under Section 70-A of the Bankruptcy Act, had a right to step into the shoes of the most favored creditor under Section 47-A, and with himself constituted as an ideal creditor with a lien by legal or equitable proceedings, or an execution returned wholly unsatisfied, assail for the benefit of all creditors any and all void liens or fraudulent transfers, under either Section 70-E or Sections 67-A or 67-B of the Bankruptcy Act, as the in-

dividual case might require, coupled with the local law of the state under which the most favored creditor would have derived his right.

It is sufficient to support a decree if there were one creditor who could have set aside the conveyance.

Evans v. Wood (Idaho Supreme Court), 241 Pac. 609;

> "The test is whether there exists a class properly included in the language of the amendment and that of the Alabama registration act. It is conceded that a judgment creditor holding a lien by execution is such a class. The trustee therefore is vested with the right by the amendment and the registration act of that class to avoid unrecorded conditional sales."

In re Calhoun Supply Co., 189 Fed. 537 (U. S. Circuit Court, Alabama).

And that the Trustee may make any objection to an unrecorded or void conveyance or mortgage that a lien creditor might make has been repeatedly held by Circuit Courts of Appeal throughout the country. This doctrine was laid down by the United States Circuit Court of Appeals for the Ninth Circuit in the following cases:

Scandinavian American Bank v. Sabin, 227 Fed. 581;
Meier Frank Co. v. Sabin, 214 Fed. 231;
National Bank of Bakersfield v. Moore, 247 Fed. 913.

And by the United States Circuit Court of Appeals for the Seventh Circuit in:

In re Pittsburgh Big Muddy Coal Co., 215 Fed. 705.

Distribution of Proceeds

The first reported case in an appellate court involving the question of distribution was the *Matter of Kohler,* 159 Fed. 871, decided by the United States Circuit Court of Appeals for the Sixth Circuit in 1908. In that case an Ohio bankrupt had transferred to his wife, without consideration, certain shares of stock. The transfer was made two years prior to the filing of the petition in bankruptcy. At the time of the transfer he was indebted in the sum of $461,108.69. After the transfer he contracted additional debts amounting to $1,300,000.00, all of which indebtedness was scheduled in his bankruptcy proceeding. The Trustee in Bankruptcy was requested by certain creditors who had been affected by the transfer to bring suit to set it aside, but failed to do so. The creditors who had been affected by the transfer and whose claims had existed prior to it then brought suit. A compromise was finally effected by the Trustee under the direction of the Bankruptcy Court and the suit was settled for $29,100.00. This sum was paid to the Trustee and a controversy then arose as to how the recovery should be distributed. The creditors whose claims had existed prior to the fraudulent transfer contended that the entire sum should be distributed pro rata among them alone, while the creditors whose claims came into existence subsequent to the transfer contended that it should be distributed pro rata among all creditors of the bankrupt who had provable claims on file.

The Referee held that the fund derived from this litigation should be distributed among all of the creditors of the bankrupt. The District Court took a different

view than did the Referee, and, on the theory that the creditors whose claims came into existence after the fraudulent transfer had occurred, had in no way been defrauded, reversed the Referee and ordered the proceeds distributed pro rata among the creditors whose claims had accrued prior to the transfer. The matter was then taken to the United States Circuit of Appeals for the Sixth Circuit, and in reversing the District Court the Circuit Court of Appeals said:

> "It is apparent from the reading of the bankruptcy law, that one of its chief objects was to prevent fraudulent preferences and conveyances by providing means for setting them aside and distributing the proceeds equally among all the creditors. Special provisions are made with respect to preferred creditors. (Sections 60-A, 60-B.) Such provisions are also made with respect to liens. (Sections 67-A, 67-B, 67-C, 67-D and 67-E.) All these relate to preferences or liens taken within four months prior to the filing of the petition in bankruptcy. In all these cases, it is provided that the property covered by the conveyance or lien, 'shall pass to the trustee as a part of the estate of the bankrupt, unless the court shall, on due notice, order that the right to such levy, attachment, judgment or other lien shall be preserved for the benefit of the estate.'
>
> "In Section 70, it is broadly provided that the trustee shall be vested, by operation of law with the title of the bankrupt, to all 'property transferred by him in fraud of his creditors.' It is apparent this provision applies to all property transferred by the bankrupt at any time in fraud of his creditors."

Further on the Circuit Court of Appeals says:

> "One object of the bankruptcy law is to prevent preferences and secure equality. The letter of the law, from which we have quoted, provides for an equal distribution. All the estate of a bankrupt is to go to the trustee. This includes preferences and property fraudulently conveyed. In our view, the strong objection to the construction of the lower court is that it provides a ready method of effectuating preferences. A man heavily in debt, and likely to go in deeper, in other words, insolvent, but yet in business, may convey a large part of his property to his wife. Having thus put out an anchor to windward, he has the satisfaction of knowing that if the conveyance stands, his wife is taken care of, but if it is set aside, the creditors existing then will be preferred over the later ones. There may be reasons why the bankrupt would like to prefer his earlier over his later creditors. If so, here is a method ready at hand for the purpose."

And in the opinion the Circuit Court of Appeals quotes with approval the doctrine laid down by the appellate division of the Supreme Court of New York *In the Matter of Gray*, 47 App. Div. 554, 62 N. Y. Supp. 618, 3 A. B. R. 647, in which it was held that the right of action to avoid alleged fraudulent transfers made more than four months prior to the petition in bankruptcy vests in the Trustee and holding that:

> "'In either case the avails must be distributed equally among the creditors.'"

The Circuit Court of Appeals closes the opinion with:

> "The judgment of the lower court is reversed and

the cause remanded with directions to order the distribution of the money referred to among *all* the creditors." (Italics ours.)

The foregoing decision covers a case identically in point with the present case except in the Kohler case there were only two classes of creditors instead of three. The reasoning of the court in the Kohler case, however, seems to be very logical, and we believe that it correctly states the law.

In *Mullen v. Warner,* 11 Fed. 2nd. 62, the United States Circuit Court of Appeals for the Fourth Circuit said:

"The contention of the petitioner is that since in the absence of bankruptcy, only antecedent creditors could have avoided the conveyance; and since because of the intervention of bankruptcy the trustee was substituted for such creditors to secure rights which would have inured to their benefit alone, the recovery by the trustees should be held to be for their exclusive benefit and that subsequent creditors, who could not have set aside the conveyance, should not be allowed to participate in the recovery. While there is much that is plausible in this contention, it is not supported by the provisions of the Bankruptcy Act. Undoubtedly the right of the trustee to set aside the conveyance existed because of the right of antecedent creditors to avoid same; but this right was derived from Section 70-E, of the Bankruptcy Act, which provides that the trustee may avoid any transfer by the bankrupt of his property which any creditor of the bankrupt might have avoided and may recover the property so transferred, but makes no provision for the holding of the property recovered by the avoidance of such transfer for any par-

ticular creditor or class of creditors. To hold that the recovery by the trustee in such a case should go to the antecedent creditors alone instead of being held for distribution under the general provisions of the act, would be to read into the statute a provision which Congress has not enacted and one which we think is at variance with the spirit of the statute as embodied in its other provisions.

"The Bankrupcy Act contemplates an equal division among the bankrupt's creditors with no preferences except those specifically designated in the statute. It is accordingly provided by section 67-B that whenever a creditor is prevented by the bankruptcy from enforcing his rights as against a lien created by his debtor the trustee shall be subrogated to and enforce the right of such creditor *for the benefit of the estate.* Can it be that when the trustee avoids a *lien* through subrogation to the right of a creditor he does so for the benefit of the estate, but when he avoids a *fraudulent conveyance,* he does so for the exclusive benefit of such creditor? We think not. Such a distinction would certainly seem to be repugnant to be presumed intention of the act and we think that it is repugnant also to its express provisions. It is true that the words 'for the benefit of the estate' were not added to section 70-E as they were to 67-B, but the addition of these words was not necessary. The power vested in the trustee by Section 70-E is the power not only to avoid the fraudulent conveyance but to recover the property conveyed. In the absence of contrary provisions this recovery would be presumed to be for the benefit of the estate. But the matter is not left to presumption, for Section 70-A expressly vests the trustee with property transferred by the bankrupt in fraud of creditors. The antecedent creditors have

no lien upon the property or the fund realized from it, their right in the absence of bankruptcy being merely the right to set aside the fraudulent conveyance and subject the property to levy under execution. The Bankruptcy Act gives them no preference. Consequently the recovery by the trustee is held for distribution in accordance with section 65 of the Act, which makes no distinction between antecedent and subsequent creditors, but provides that 'Dividends of an equal percentum shall be declared and paid on all allowed claims.' The whole confusion as to the right of antecedent creditors arises from assuming that, because the conveyance is avoided under the state law, the fund realized must be distributed under that law, a view expressly repudiated by the Supreme Court of the United States in Miller v. New Orleans Acid & Fertilizer Co., 211 U. S. 496, 21 Am. B. R. 416, 29 S. Ct. 176.

"A decision which seems to us conclusive of the question presented is the case of Globe Bank v. Martin, 236 U. S. 288, 34 Am. B. R. 162, 35 S. Ct. 377. In that case there was a fraudulent conveyance which, under the laws of Kentucky, was void as to antecedent but not as to subsequent creditors. A suit to set aside the conveyance was instituted by antecedent creditors and under the Kentucky practice an attachment levied upon the property which was the subject of the suit. During the pendency of the suit and within four months after its institution the debtor was adjudged bankrupt, and the bankruptcy court entered an order directing that the attachment lien be preserved for the benefit of the estate and that the trustee intervene in the state court and prosecute an action for the recovery of the property. This was done and the property recovered. A decree adjudging that the antecedent

creditors were entitled to the entire fund was reversed by the Circuit Court of Appeals of the Sixth Circuit and a decree was entered by that court directing a distribution of the fund among all the creditors of the estate. This was affirmed on appeal to the Supreme Court of the United States.

"It is argued by counsel that a distribution among all the creditors was directed in the case of Globe Bank v. Martin, supra, because the trustee sought to preserve the lien obtained by creditors, under section 67-F of the Act, for the benefit of the estate. But we do not understand this to be the basis of that decision. The court points out that the trustee is by 70-A of the Bankruptcy Act vested with title to property transferred in fraud of creditors, and that by 70-E he is authorized to avoid any transfer by the bankrupt which any creditor may avoid. It next shows that the antecedent creditors had no lien on the property conveyed until the filing of the attachment and that the lien of the attachment was void, having been filed within four months of the bankruptcy, except as it was preserved under 67-F for the benefit of the estate. Miller v. New Orleans Acid & Fertilizer Company, supra, was cited as authority for the proposition that after the fraudulent conveyance was set aside *under section 70* of the Bankruptcy Act, the bankruptcy court had the right to determine for itself the disposition of the fund. In our opinion the doctrine announced in Globe Bank v. Martin clearly covers the distribution of funds recovered by the Trustee in proceedings under 70-E of the Bankruptcy Act, whether a lien obtained by creditors is preserved under 67-F or not."

In *Campbell v. Dalbey,* 11 Fed. 2nd. 62, the United States Circuit Court of Appeals for the Fourth Circuit said:

> "As stated in the former opinion of this case, the trustee, even though the right to preserve the lien under Section 67-F had been lost, had the right to avoid under Section 70-E any transfer by the bankrupt which any creditor might have avoided. The bank's suit was brought within one year from the giving of the mortgage, and was not prescribed by the state law (La. Revised Civil Code, art. 1987); and the judgment of the state court which set aside that mortgage in so far as it affected the bank is authorized by article 1977 of that code. It follows from section 70-E that the trustee not only succeeded to the bank's right to avoid appellant's mortgage to the partial extent that it affected the bank, *but also was given the authority to avoid that mortgage fully and completely and recover the entire mortgaged property or its value, for the benefit of all the creditors of the bankrupt.* Stellwagen v. Clum, 245 U. S. 605.
>
> "The judgment is affirmed." (Italics ours.)

In *Cohen v. Schultz,* 43 Fed. 2nd. 340, the United States Circuit Court of Appeals for the Third Circuit, as late as August 28, 1930, passed on this question. One Aurelio Conforti and his wife on January 5, 1928, transferred certain properties to a third party. On the same day one Jacob Schultz, a creditor, docketed a judgment for $446.64 against him. On January 19, 1928, Schultz docketed another judgment against him for the sum of $1255.43. On June 22, 1928, Conforti filed a voluntary petition in bankruptcy and Cohen was elected trustee.

The trustee filed a suit to set aside the conveyance by the bankrupt and the suit was finally settled for $5000.00. Schultz, as a creditor, then insisted that he had a right to a lien against the proceeds of this settlement to the extent of his judgments because of the fact that by virtue of his judgments against the bankrupt he had a right to have set aside the fraudulent transfers made by the bankrupt, and the District Court entered an order in his favor. On appeal the United States Circuit Court of Appeals for the Third Circuit, in reversing the District Court, said:

> "It is upon the $5,000 thus received by the trustee that the appellee is here trying to impress the liens. Does Schultz by virtue of his judgments against the bankrupt, which he did not attach to the real estate in question, have a lien against the settlement affected by the trustee in the litigation to set aside the mortgage? We know of no principle of law, decisional or statutory, which gives him such a lien. * * *
>
> "Section 70-A of the Bankruptcy Act (11 U. S. C. A., Sect. 110-a) expressly vests the trustee with property transferred by the bankrupt in fraud of creditors. Antecedent creditors have no lien upon the property thus conveyed or the fund realized from it. Their right is merely the right to set aside the fraudulent conveyance and subject the property to levy under execution. The Bankruptcy Act does not give them preference. Consequently the recovery by the trustee is held for distribution to creditors generally with no preferences, except those specially designated in the statute, and Schultz is not one of those creditors. So it does not appear that the appellee could impress his lien upon the $5,000

even if the transfer had been fraudulent, and since it has not been so declared, he has no claim whatever to a preference. Mullen v. Warner (C. C. A., 4th Cir.), 11 Fed. 2nd. 62, Globe Bank v. Martin, 236 U. S. 288."

In *Globe Bank v. Martin*, 236 U. S. 288, this Court said:

"It is contended, however, by the appellants, that if we assume that under section 67-F of the Bankruptcy Act, the property or its proceeds must come to the trustee, to be distributed by him under the orders of the bankruptcy court for the benefit of the estate that inasmuch as, under the statute of Kentucky, creditors existing prior to the making of the deed in question were entitled to be preferred in the distribution of the proceeds, that right is protected by sub-section 5 of section 64-b of the Bankruptcy Act, which provides that the debts to have priority, except as therein provided, and to be paid in full out of bankrupt estates, are, among others,

> 'debts owing to any person who, by the laws of the states or the United States, is entitled to priority;'

and it is contended that this sub-section, as considered by the Circuit Court of Appeals of the Sixth Circuit in an opinion written by the late Justice Lurton (Re Bennett, 18 Am. B. R. 320, 82 C. C. A. 531, 153 Fed. 673), maintains that position. But an examination of that case shows that it dealt with a statutory lien created under section 487 of the Kentucky statutes, giving preferences to persons furnishing materials or supplies to manufacturing companies, and creating a lien upon the property in

cases of such companies in case of an assignment for the benefit of creditors, or where the property is distributed among the creditors by operation of law or by act of the company. It was held that such statutory lien gave a substantial right in or inchoate lien upon the property from the date of furnishing the material, within the spirit and meaning of section 64-B, sub-section 5, of the Bankruptcy Act. That case, and such cases as Re Laird (C. C. A., 6th Cir.), 6 Am. B. R. 1, 48 C. C. A. 538, 109 Fed. 550, which dealt with labor claims, recognize the purpose of Congress in passing Section 64-B, to maintain statutory liens and preferences in such cases in the distribution of the bankrupt estate.

"We are unable to see that the case has any bearing upon the construction of section 67-F and the cases now under consideration. Under our system of bankruptcy, and in the administration of assignments under State laws, there are certain persons, such as those furnishing material or labor, that, in certain specific ways, are given preference in the distribution of insolvent estates. It is a statutory lien of that kind with which the court dealt in Re Bennett."

The foregoing decisions of various Circuit Courts of Appeal, together with the doctrine laid down by this Court in *Globe Bank & Trust Co. v. Martin*, supra, in our opinion conclusively establishes the fact that the Circuit Court of Appeals for the Ninth Circuit erred in holding that the Trustee was required to distribute the avails of the recovery to the first two classes of creditors who would have had a right to avoid the transfer or mortgage had they obtained judgments against the bankrupt and had bankruptcy not intervened.

In addition, we are unable to see how the Circuit Court of Appeals reconciled its holding in the instant case with the plain statutory provision of Section 65-A of the *Bankruptcy Act*, which provides that:

> "Dividends of an equal per centum shall be declared and paid on all allowed claims, except such as have priority or are secured."

Section 64-B of the Bankruptcy Act expressly sets forth the claims of creditors which have priority over others and the only classification under which creditors of the first and second class could have hoped to come are under the seventh classification of Section 64-B as creditors holding "debts owing to any person who by the laws of the states or the United States is entitled to priority," and this Court in its decision in the case of *Globe Bank &Trust Co. v. Martin,* supra, forever closed that door to them. We therefore submit that on this ground alone, if no other, the decision of the Circuit Court of Appeals in this case should be reversed.

There is one other question, however, arising which is of equal importance and that is the question of the extent of the trustee's rights in his recovery. Does he avoid it, *in toto*, or does he avoid it merely to the extent of the amount of creditor's claims existing at the time of the transfer or mortgage complained of? If the former is true, the chattel mortgage for $10,000 given to Sylvan G. Bay is wholly null and void so far as the Trustee in Bankruptcy is concerned. If the latter is true, as the Circuit Court of Appeals decided, then we are back again in the same situation wherein the holder of a mortgage denounced by a state statute to be con-

clusively presumed to be fraudulent and void as to certain creditors can still come in ahead of general creditors of the bankrupt. In other words, assuming for the sake of argument that the property was worth $13,000, that the claims of creditors entitled to avoid the mortgage amounted to $2,000, the Trustee would then be permitted to avoid the mortgage to the extent of $2,000, the recovery would go into the general fund for the benefit of all creditors to apply on a dividend and before the Trustee could disburse any of the funds in excess of $2,000 to general creditors, he would be obliged to pay the $10,000 mortgage in full. If there were any leavings after the mortgage had been paid, these leavings would then go to the creditors of the bankrupt. This we do not believe to be the law any more than we believe it to be the law that the recovery made by the Trustee is made for the benefit only of the creditors affected by the fraudulent transfer.

Section 67-A of the *Bankruptcy Act* provides that:

> "Claims which for want of record or for other reasons would not have been valid liens as against the claims of the creditors of the bankrupt *shall not be liens against his estate.*" (Italics ours.)

Section 67-B provides that:

> "Whenever a creditor is prevented from enforcing a lien created, or attempted to be created, by his debtor, who afterwards becomes a bankrupt, the trustee of the estate of such bankrupt shall be subrogated to and may enforce such rights of such creditor *for the benefit of the estate.*" (Italics ours.)

In the case at bar, the creditors of the first and second classes could have seized the mortgaged property, caused an execution to be levied upon it, and at execution sale could have obtained a perfect title to the property as against the attempted lien of the mortgagee.

Judson v. Lyford, 84 Cal. 507;
Butler v. San Francisco Gas & Electric Co., 168 Cal. 32;
Bull v. Ford, 66 Cal. 176;
Watson v. Rodgers, 53 Cal. 401;
Brown v. O'Neal, 95 Cal. 262-267.

Under Section 47-A of the Bankruptcy Act the Trustee, standing in the shoes of a creditor holding a lien by legal or equitable proceedings and in his artificial, statutory status as an execution creditor with a judgment returned wholly unsatisfied, is subrogated under Section 67-B to the rights of these two classes of the most favored creditors under the local laws of California. It is our contention then, that the Trustee has a right, the same as would the creditors in class one and class two, to wholly avoid the attempted lien on the property of the bankrupt.

Chalmers v. Sheehy, 182 Cal. 459.

In *Campbell v. Dalbey,* 23 Fed. 229, the United States Circuit Court of Appeals for the Fifth Circuit says:

> "It follows from Section 70-E that the trustee not only succeeded to the bank's right to avoid appellant's mortgage to the partial extent that it affected the bank, but also was given the authority to avoid that mortgage *fully and completely and recover the*

> *entire mortgaged property or its value* for the benefit of all the creditors of the bankrupt. Stellwagen v. Clum, 245 U. S. 605. (Italics ours.)

The foregoing decision is of particular interest because of the fact that in it the United States Circuit Court of Appeals for the Fifth Circuit completely reversed the position formerly taken by it in *American Trust & Savings Bank v. Duncan,* 250 Fed. 780, back in 1918. In *American Trust & Savings Bank v. Duncan* the United States Circuit Court of Appeals for the Fifth Circuit held that the avails of a successful suit by a Trustee to avoid a fraudulent transfer under Section 70-E inured only to the benefit of the creditor or creditors affected by the transfer. That decision stood alone until December, 1927, at which time the decision in *Campbell v. Dalbey* was handed down. In the latter decision the United States Circuit Court of Appeals for the Fifth Circuit completely reverses its former position and fell in line with the other circuits which had passed on that question. In fact, the lone dissenting authority of *American Trust & Savings Bank v. Duncan* was criticised by the United States Circuit Court of Appeals for the Fourth Circuit in *Mullen v. Warner,* 11 Fed. 2nd. 62, in the following language:

> "We have examined carefully the case of American Trust Company v. Duncan, 254 Fed. 780, cited by counsel and it apparently supports the decree rendered below; but while we have great respect for the court which rendered that decision, we cannot follow it. The doctrine therein announced is at variance with our interpretation of the Bankruptcy Act and, it seems to us, is in clear conflict with the

decision of the Supreme Court of the United States in Globe Bank v. Martin, supra. Our examination of the authorities from other jurisdictions convinces us also that the decision in American Trust Co. v. Duncan is not in harmony with the current of authority; for it seems to be generally settled that the recovery of the trustee of property conveyed in fraud of creditors inures to the benefit of all creditors and not merely to the benefit of those who might have attacked the conveyance under the state law. Kehr v. Smith, 20 Wall 31; Platt v. Mead, 9 Fed. 91; McCrory v. McDonald (Miss.) 80 So. 643; Riggs v. Price (Mo.), 43 A. B. R. 413; In re Kohler, 159 Fed. 871; Farmers' Co-operative Co. v. Barlow, 202 Fed. 1008; In re Gray, 47 App. Div. 554."

Whether or not the fact that the Circuit Court of Appeals for the Fifth Circuit found itself entirely out of harmony with other appellate courts was the motivating cause, we do not know, but the fact remains that in 1927 that Court unqualifiedly held in *Campbell v. Dalbey*, supra, that the Trustee had a right to avoid an invalid mortgage, not to the partial extent that it affected the creditor whose rights had been invaded, but *"fully and completely* and recover the entire mortgaged property or its value for the benefit of all creditors of the bankrupt." (Italics ours.)

In *Farmers' Co-operative Company v. Barlow*, 202 Fed. 1008, the District Court of the United States for the District of North Dakota, speaking through Judge Amidon, said:

"The trustee in bankruptcy derives his rights and powers from the statute, and not from the creditors

of the estate. If any creditor under the local statute can obtain priority over an unfiled or unrecorded instrument by levy of attachment or execution, the trustee in bankruptcy, under section 47 as amended, has all the rights and remedies of such creditor * * * To hold that the trustee derives his rights from the creditors of the particular estate, instead of the statute, would greatly embarrass the administration of the estate in bankruptcy. It would require first an investigation to ascertain what credit was given subsequent to the unrecorded instrument. This in mercantile cases would be a difficult inquiry, and would often require the splitting of current accounts. Again, under this interpretation, the fund arising from the property covered by the unrecorded instrument would have to be first apportioned among the subsequent creditors, to the exclusion of all other creditors, then to the lien-holder, and finally to the general creditors. In re Riehl, 200 Fed. 455. I do not think that Congress, by the 1910 amendment of section 47, intended such a result. A fair interpretation of the statute in the light of the weight of authority, as above pointed out, gives to the trustee all the rights of the most favored creditor under the the local law, and any property thus held by the trustee becomes a part of the general estate to be apportioned among all creditors in accordance with the provisions of the Bankruptcy Act on that subject."

The Supreme Court of California in *Noyes v. Bank of Italy*, 206 Cal. 266, says:

"Section 47-A-2 of the Bankruptcy Act, June 25, 1910 (Chap. 412, sec. 8, 36 Stats. at Large, 838, 840; Comp. Stats. 1913, Secs. 9586, 9631; U. S. Code (U. S. C. A.), title 11, sec. 75), provides:

'And such trustees as to all property in the custody, or coming into the custody of the bankruptcy court, shall be deemed vested with all the rights, remedies and powers of a creditor holding a lien by legal or equitable proceedings thereon; and also, as to all property not in the custody of the bankruptcy court, shall be deemed vested with all the rights, remedies and powers of a judgment creditor holding an execution duly returned unsatisfied.'

"Interpreting said section 47-A-2 of the Bankruptcy Act the Supreme Court of the United States has held that the trustee acquired a lien status as of the time when the petition in bankruptcy was filed. (Bailey v. Baker Ice Machine Co., 239 U. S. 268; 36 Sup. Ct. Rep. 50); (see also Martin v. Commercial National Bank, 245 U. S. 513; 38 Sup. Ct. Rep. 176, see also Rose's U. S. Notes, 4 Cal. Jur., pp. 59, 60, 62, 63, and cases cited.)"

Further down the Court says:

"In other words, the trustee was intended to be placed in the position of a lien creditor who would, but for the bankruptcy proceedings, be entitled to attack the alleged void mortgage and to enable him to protect the interests of general creditors against invalid liens, unlawful transfers, etc. I Collier on Bankruptcy, 12th ed., p. 728, et seq."

The Supreme Court of California also passes on the question as to the position of the Trustee in stepping into the shoes of creditors whose claims came into existence between the date of the execution of the mortgage and its recordation. In that regard the Court says:

"The term *creditors* is general and applies to creditors existing prior to the mortgage, as well as

subsequent." Citing *Cardenas v. Miller,* 108 Cal. 250.

The Supreme Court of California also discussed the doctrine laid down by the United States District Court for the Southern District of California in the *Matter of Hansen,* 268 Fed. 904, in which the United States Judge Bledsoe decreed a chattel mortgage withheld from recordation twenty-one (21) days after its acknowledgment to be null and void in so far as creditors were concerned.

See also:

Pierson v. Hickey, 16 S. D. 46;
Butler v. San Francisco Gas Co., 168 Cal. 32;
Bull v. Ford, 66 Cal. 176;
Oliver v. Bennan, 292 Fed. 201.

In *Willamette Casket Co. v. Cross Undertaking Co.,* 12 Wn. 190, the Supreme Court of Washington, construing a statute similar to Section 2957 of the Civil Code of California, used almost identically the same language as was used by the Supreme Court of California in *Noyes v. Bank of Italy, supra,* in sum and substance holding that a chattel mortgage withheld from record an unreasonable length of time was void not only as to subsequent creditors, but to prior creditors, and even went so far as to hold that creditors who became such subsequent to the filing of the chattel mortgage were entitled to a superior right over the mortgage. This decision was followed in a subsequent case, *Manhattan Trust Co. v. Seattle Coal & Oil Company,* 16 Wn. 499, and was quoted with approval by the United States Circuit Court of Appeals for the Ninth Circuit in *Pacific State Bank v. Coats,* 205 Fed. 618.

Furthermore, it strikes us that the Circuit Court of Appeals for the Ninth Circuit has in the case at bar sought to divest the trustee of title to property which is expressly conferred upon him by Section 70-A of the *Bankruptcy Act*. Under that section the trustee takes title to all property transferred by the bankrupt in fraud of his creditors and to all property which prior to the petition he could have by any means transferred or which might have been levied upon and sold under judicial process against him. Under Section 3440 of the *Civil Code* of California and the California decisions hereinbefore cited, *Judson v. Lyford*, 84 Cal. 507, et seq., this property could have been levied upon and sold by any of the creditors in class one and class two and certainly it was property transferred in fraud of creditors. But under the decision of the United States Circuit Court of Appeals for the Ninth Circuit in this case, the trustee is deprived of title to that property, at least to the partial extent of the amount of the void encumbrance against it.

Section 70-E of the *Bankruptcy Act* has been a part of the Act since its origin. It seems peculiar that Congress in enacting this section would specifically provide that "the trustee may avoid *any* transfer by the bankrupt of his property which *any* creditor of such bankrupt might have avoided and *may recover the property so transferred, or its value, from the person to whom it was transferred,*" if it were the intent of the framers of the law that the trustee could avoid transfers only to the extent of the amount of creditors' claims affected by them. It would seem to us that if such had been the

intention of Congress, Section 70-E would have been made to read:

> "The trustee may avoid any transfer by the bankrupt of his property which any creditor of the bankrupt might have avoided *to the extent of the amount of the claims of such creditor or creditors and may recover the property so transferred to the extent of the amount of such claims from the person to whom it was transferred, etc.*" (Italics ours.)

This, Congress has not seen fit to enact, but, on the contrary, in 1910 strengthened Section 70-E by placing a trustee in the status of an execution creditor under the amendments to Section 47-A. It therefore appears to us that the Circuit Court of Appeals for the Ninth Circuit has read into the Act provisions that were neither intended by the original framers of the Act, nor by the Congress which subsequently amended and strengthened the Act in 1910, to place the trustee in the most favorable position possible, with regard to transfers that were fraudulent at law or in fact.

We therefore respectfully submit that the Circuit Court of Appeals for the Ninth Circuit erred in two particulars, first, in holding that the trustee's rights were limited by the amount of claims affected by the fraudulent transfer, and second, by holding that the recovery under those limited rights was only for the benefit of the favored class of creditors affected thereby. We respectfully submit that for these reasons the judgment of the Circuit Court of Appeals should be reversed and the cause sent back to the District Court with directions to affirm the original order of Referee Rupert B.

Turnbull, setting aside the mortgage *in toto* and distributing the avails to all the creditors of the bankrupt.

Conclusion

The importance of the questions herein involved cannot be exaggerated. If the lone dissenting decision of the Circuit Court of Appeals for the Ninth Circuit is permitted to stand as against four other circuits to the contrary, it will lead to unconscionable possibilities. If a trustee in bankruptcy is limited in avoidance of fraudulent transfers and liens to the amount of creditors' claims affected thereby, the gate will be left wide open for bigger and better frauds. Under such a rule, a bankrupt could own a large business block or office building in downtown Los Angeles, San Francisco or Portland. The building could be worth $3,000,000 and he could owe $50,000 in debts. At a time when he owed indebtedness in the comparatively small sum of $50,000 he could quietly transfer this building to his wife or a friend, without consideration, record the transfer, and continue incurring indebtedness with eastern creditors, who, while they might have constructive notice of the transfer, would actually know nothing about it. He could pile up three or four hundred thousand dollars in debts and file a petition in bankruptcy. When the trustee was elected and attacked the voluntary transfer, the bankrupt's fraudulent grantee could with impunity go on the witness stand and under examination admit to the trustee that the transfer had been made to him, or her, voluntarily and for the express purpose of delaying and defrauding the bankrupt's creditors. The fraudulent grantee could then tender the trustee the sum of $50,000, the amount

of the claims of the creditors defrauded, and the trustee would be compelled to turn over to him the fruits of his fraud over and above $50,000 and see him walk insolently away from the court leaving three hundred thousand dollars' worth of creditors without recourse or redress from the property so fraudulently transferred, and this, notwithstanding the fact that Section 70-A of the *Bankruptcy Act* expressly vested the trustee by operation of law with "title to all property transferred by the bankrupt in fraud of his creditors and title to all property which prior to the filing of the petition could have been levied upon and sold under judicial process against him."

True, it may be said that in the case at bar there is no question of actual fraud involved, and that the fraud involved here is merely constructive, but in avoiding transfers under Section 70-E of the *Bankruptcy Act,* it is immaterial whether or not the transfer was actually fraudulent or constructively so, and it can be avoided even though a full consideration were paid.

Brown v. Kossove, 255 Fed. 806.

And such transfers are decreed void, regardless of individual hardship or the best of good faith existing between the parties.

Brown v. O'Neal, 95 Cal. 262-267.

And although the transfer in question is merely constructively fraudulent, we see no distinction between a constructively fraudulent transfer and one that is actually fraudulent in fact. Actual fraud is extremely difficult to prove and the burden of proof where fraud is involved is much heavier than is the burden of proof in an ordi-

nary civil case. Fraud is never presumed, and in order to prove actual fraud, a trustee in bankruptcy is at an extreme disadvantage, usually having relatives and friends of the bankrupt as his sole and only witnesses. However, in any case of actual fraud there are usually elements involved which run afoul of statutes of the state which make certain acts in connection with transfers conclusively presumptive of fraud. It is to facilitate this proof that such statutes were enacted. They were intended to place creditors and trustees less at the mercy of the scheming debtor.

Woods v. Bugbey, 29 Cal. 467-477.

Section 3440 of the *Civil Code* of California is a fair example of such a statute. (*Woods v. Bugbey*, supra.) It was enacted for the purpose of assisting creditors and persons on whom the estate of the debtor devolved in trust, and for the purpose of circumventing schemes devised by calculating debtors. If by judicial construction the effectiveness of statutes such as Section 3440 and Section 70-E of the *Bankruptcy Act* is impaired, conscientious and energetic trustees in bankruptcy, deprived of these effective weapons, will be literally hamstrung in their efforts to compel an accounting from actually fraudulent grantees of dishonest bankrupts. (*Woods v. Bugbey*, supra.) Such trustees will wage battle armed with wooden swords against the sharpened rapiers of fraudulent schemers who seek to unload their debts and at the same time skilfully conceal their property with the aid of relatives and friends.

We do not feel that this Court will uphold such a construction of an Act which is designed to relieve misfortune, but which, in order to secure the benefit thereof, requires the "utmost honesty on the part of the bankrupt."

In re Becker, 106 Fed. 54;
In re Merritt, 28 Fed. (2d) 679.

Respectfully submitted,

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